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No. 467

In the Supreme Court of the United States

OCTOBER TERM, 1942

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SYLVIE R. GRIFFITHS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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SYLVIE R. GRIFFITHS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above case on July 20, 1942, affirming the decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 11) is unreported. The *per curiam* opinion of the Circuit Court of Appeals for the Second Circuit (R. 20), is reported at 129 F. (2d) 321.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 20, 1942 (R. 20). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a dividend in common stock upon common stock supported by corporate earnings and profits, where there is no other class of stock outstanding, is constitutionally subject to tax without apportionment.

CONSTITUTIONAL PROVISIONS, STATUTE, AND REGULATIONS INVOLVED

The provisions of the Constitution, the statute and the regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The taxpayer was the owner and holder of 10½ shares of capital stock of Standard Oil Company (New Jersey). (R. 6.) Standard had a total authorized capitalization of 30,000,000 shares of stock of a par value of $25 each. On January 1, 1939, there were outstanding approximately 26,500,000 shares, which had an aggregate par value of $662,500,000 (R. 4).

In addition, on January 1, 1939, the corporation had a capital surplus on its books of approximately $66,500,000 and earned surplus and undivided prof-

its of approximately $130,000,000. The amounts represented by the outstanding capital stock, capital surplus, earned surplus and undivided profits were invested in assets or otherwise used by the corporation for purposes of its business (R. 4).

All of the shares of the capital stock of the corporation which were outstanding during the year 1939 were of the same class and character. The rights and interests of the holder of each share were identical with those of the holder of every other share (R. 4).

On May 1, 1939, the board of directors of Standard adopted resolutions directing that on June 15, 1939, there be distributed to the stockholders of record at the close of business on May 16, 1939, additional shares of the capital stock of the corporation on the basis of two shares of stock for each 200 shares held on the record date. The earned surplus account would be charged with $27.50 for each additional share of capital stock issued. The capital stock account would be credited with the par value of such share, namely, $25, and the capital surplus account would be credited with $2.50. The transfers were made in accordance with these directions and the new shares were divided among the stockholders in the proportions described. The total amount transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913 (R. 4–5).

On November 1, 1939, Standard's board of directors adopted further resolutions directing that on December 15, 1939, there be distributed to the stockholders of record at the close of business on November 15, 1939, additional shares of capital stock of the corporation on the basis of three shares for each 200 shares held on the record date. The earned surplus account would be charged with $27.50 for each additional share of the capital stock issued. The capital stock account would be credited with the par value of such share, namely, $25, and the capital surplus account would be credited with $2.50. The transfers were made in accordance with these directions, and the new shares were divided among the stockholders in the proportions described. The total amount transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913 (R. 5).

The shares of stock thus distributed as stock dividends on June 15, 1939, and December 15, 1939, respectively, were of precisely the same class and character as the shares of the capital stock in respect of which the distributions were made. In each instance the proportionate interest of each shareholder in the corporation immediately after the issuance and distribution of the new shares was the same as his former interest. In neither in-

stance did any shareholder have a right to an election or option to receive cash or other property in lieu of his proportion of additional shares of capital stock issued and distributed (R. 5–6).

The taxpayer, on June 15, 1939, received as her proportion of the stock dividend distributed on that date 1.01 shares of the capital stock of the corporation. The fair market value of each share of stock of the corporation on June 15, 1939, immediately after receipt of the additional shares by the taxpayer, was $42.50. The fair market value of the 1.01 additional shares was $42.93 (R. 6).

On December 15, 1939, the taxpayer received in respect of the 102.01 shares of stock of the corporation which she now held, 1.53 additional shares of the stock of the corporation as her proportion of stock dividend distributed on th date. The fair market value of each share of the stock of the corporation on December 15, 1939, immediately after the receipt of the additional shares by the taxpayer, was $43.1875. The fair market value of the 1.53 additional shares was $66.08 (R. 6).

The Commissioner assessed the deficiency based on the failure of the taxpayer to include in her income the fair market value of the two and one-half shares of common stock of Standard received by her as a dividend (R. 8–9). This determination was reversed by the Board of Tax Appeals (R. 12). The Circuit Court of Appeals affirmed on the authority of *Eisner* v. *Macomber*, 252 U. S. 189.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividends could not constitutionally be subjected to tax.

2. In failing to hold that the additional common stock which the taxpayer received as dividends upon her common stock was taxable to her.

3. In affirming the decision of the Board of Tax Appeals.

REASON FOR GRANTING THE WRIT

This is a test case designed to challenge directly the authority of *Eisner* v. *Macomber*, 252 U. S. 189. The public importance of a re-examination of that decision has been set forth in the Government's petitions for certiorari and rehearing thereon in *Helvering* v. *Sprouse*, October Term, 1942, No. 22. The Government proposes to urge that *Eisner* v. *Macomber* be overruled both in the *Sprouse* case and in *Strassburger* v. *Helvering*, October Term, 1942, No. 66. Because of the importance of the question and because the issue is now before the Court in the *Sprouse* and *Strassburger* cases, review of the instant cause is also appropriate.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.

OCTOBER 1942.

APPENDIX

Constitution of the United States:

Article I, Section 2, Clause 3.—Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons * * *.

Article I, Section 8, Clause 1.—The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

* * * * *

Article I, Section 9, Clauses 4 and 5.—No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

No Tax or Duty shall be laid on Articles exported from any State.

* * * * * *

Sixteenth Amendment.—The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * dividends * * *

* * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

* * * * * *

(f) *Stock Dividends.*—

(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) *Election of Shareholders as to Medium of Payment.*—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights

to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

* * * * *

(j) *Valuation of Dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

Treasury Regulations 101, promulgated under the Revenue Act of 1938.

ART. 115–7 [as amended by T. D. 5110, 1942–4 Int. Rev. Bull. 7]. *Stock dividends.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution.

The provisions of Article 115–7 deleted by T. D. 5110, 1942–4 Int. Rev. Bull. 7, were as follows:

The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the

meaning of the Constitution.[1] The distinction between a stock dividend which does not, and one which does, constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution is the distinction between a stock dividend which works no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and a stock dividend where there either has been a change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholder after the distribution is essentially different from his former interest. A stock dividend constitutes income if it gives the shareholder an interest different from that which his former stock holdings represented. A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old.

* * * * *

[The three remaining paragraphs contain examples illustrating the foregoing rules.]

---

[1] See *Eisner* v. *Macomber* (252 U. S. 189, T. D. 3010, C. B. 3, 25 (1920)); and *Koshland* v. *Helvering* (298 U. S. 441, Ct. D. 1124, C. B. XV–1, 219 (1936)). Compare *United States* v. *Phellis* (257 U. S. 156, T. D. 3270, C. B. 5, 37 (1921)); *Rockefeller* v. *United States* (257 U. S. 176, T. D. 3271, C. B. 5, 34 (1921)); *Cullinan* v. *Walker* (262 U. S. 134, T. D. 3508, C. B. II–2, 55 (1923)); *Weiss* v. *Stearn* (265 U. S. 242, T. D. 3609, C. B. III–2, 51 (1924)); and *Marr* v. *United States* (268 U. S. 536, T. D. 3755, C. B. IV–2, 116 (1925)).

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BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 8) is unreported. The *per curiam* opinion of the Circuit Court of Appeals for the Second Circuit (R. 14) is reported at 129 F. (2d) 321.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 20, 1942 (R. 14). The petition for a writ of certiorari was filed on October 20, 1942, and was granted on November 23, 1942. The jurisdiction of this Court rests upon Section

240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a dividend in common stock upon common stock supported by corporate earnings and profits, where there is no other class of stock outstanding, is constitutionally subject to tax as income without apportionment, under Sections 22 and 115 of the Internal Revenue Code.

CONSTITUTIONAL PROVISIONS, STATUTE, AND REGULATIONS INVOLVED

The provisions of the Constitution, the statute, and the regulations involved are set forth in Appendix A, *infra*, pp. 34–43.

STATEMENT

This case involves the taxability of two stock dividends declared and paid during the year 1939.

The taxpayer was the owner and holder of 101 shares of capital stock of Standard Oil Company (New Jersey) (R. 4). Standard had a total authorized capitalization of 30,000,000 shares of stock of a par value of $25 each. On January 1, 1939, there were outstanding approximately 26,500,000 shares, which had an aggregate par value of $662,500,000. (R. 3.)

In addition, on January 1, 1939, the corporation had a capital surplus on its books of approximately $66,500,000 and earned surplus and undivided profits of approximately $130,000,000. The amounts represented by the outstanding capital

stock, capital surplus, earned surplus and undivided profits were invested in assets or otherwise used by the corporation for purposes of its business. (R. 3.)

All of the shares of the capital stock of the corporation which were outstanding during the year 1939 were of the same class and character. The rights and interests of the holder of each share were identical with those of the holder of every other share. (R. 3.)

On May 1, 1939, the board of directors of Standard adopted resolutions directing that on June 15, 1939, there be distributed to the stockholders of record at the close of business on May 16, 1939, additional shares of the capital stock of the corporation on the basis of two shares of stock for each 200 shares held on the record date. The earned surplus account would be charged with $27.50 for each additional share of capital stock issued. The capital stock account would be credited with the par value of such share, namely, $25, and the capital surplus account would be credited with $2.50. The transfers were made in accordance with these directions and the new shares were divided among the stockholders in the proportions described. The total amount transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913. (R. 3.)

On November 1, 1939, Standard's board of directors adopted further resolutions directing that on December 15, 1939, there be distributed to the stockholders of record at the close of business on November 15, 1939, additional shares of capital stock of the corporation on the basis of three shares for each 200 shares held on the record date. The earned surplus account would be charged with $27.50 for each additional share of the capital stock issued. The capital stock account would be credited with the par value of such share, namely, $25, and the capital surplus account would be credited with $2.50. The transfers were made in accordance with these directions, and the new shares were divided among the stockholders in the proportions described. The total amount transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913. (R. 3–4.)

The shares of stock thus distributed as stock dividends on June 15, 1939, and December 15, 1939, respectively, were of precisely the same class and character as the shares of the capital stock in respect of which the distributions were made. In each instance the proportionate interest of each shareholder in the corporation immediately after the issuance and distribution of the new shares was the same as his former inter-

est. In neither instance did any shareholder have a right to an election or option to receive cash or other property in lieu of his proportion of additional shares of capital stock issued and distributed. (R. 4.)

The taxpayer, on June 15, 1939, received as her proportion of the stock dividend distributed on that date 1.01 shares of the capital stock of the corporation. The fair market value of each share of stock of the corporation on June 15, 1939, immediately after receipt of the additional shares by the taxpayer, was $42.50. The fair market value of the 1.01 additional shares was $42.93. (R. 4.)

On December 15, 1939, the taxpayer received in respect of the 102.01 shares of stock of the corporation which she now held, 1.53 additional shares of the stock of the corporation as her proportion of stock dividend distributed on that date. The fair market value of each share of the stock of the corporation on December 15, 1939, immediately after the receipt of the additional shares by the taxpayer, was $43.1875. The fair market value of the 1.53 additional shares was $66.08. (R. 5.)

The Commissioner proposed to assess a deficiency for 1939 based on the failure of the taxpayer to include in her income the fair market value of the shares of common stock of Standard received by her as dividends (R. 6–7). His deter-

mination was reversed by the Board of Tax Appeals (R. 9). The Circuit Court of Appeals affirmed on the authority of *Eisner* v. *Macomber*, 252 U. S. 189. (R. 14.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividends could not constitutionally be subjected to tax.

2. In failing to hold that the additional common stock which the taxpayer received as dividends upon her common stock was constitutionally taxable to her under Sections 22 and 115 of the Internal Revenue Code.

3. In affirming the decision of the Board of Tax Appeals.

ARGUMENT

Introductory.—This case involves stock dividends of pure common upon common, supported by corporate earnings, where there was no other class of stock outstanding. The taxability of these dividends, therefore, will squarely require the overruling of *Eisner* v. *Macomber*, 252 U. S. 189. The *per curiam* opinion of the court below was based solely upon that decision (R. 14).

In *Strassburger* v. *Helvering* and *Helvering* v. *Sprouse*, Nos. 66 and 22, this Term, we undertook to show at length why *Eisner* v. *Macomber* was incorrectly decided, and we respectfully refer the Court to our brief in the *Strassburger* case for a

full exposition of our argument on this issue.[1] However, the further issue has been raised here, as it was in those cases, that the statutory provisions should be narrowly interpreted so as not to reach these dividends. Accordingly, we shall first discuss somewhat more fully the scope of the statutory provisions; we shall secondly, deal with the related question involving the Treasury regulations; and thirdly, we shall consider in greater detail the public interest which requires the re-examination of *Eisner* v. *Macomber*.

It may be observed at the outset that in none of the cases, whether decided for or against the Government, was there any suggestion that the statute failed to tax the stock dividend if it could be regarded as income within the meaning of the Sixteenth Amendment. The Ninth Circuit in the *Sprouse* case rested its decision squarely upon *Eisner* v. *Macomber*, and indeed stated that "It is conceded that under the taxing act the value of the non-voting common stock, distributed to peti-

[1] In addition, we have set forth herein in Appendix B, *infra*, pp. 44–47, a brief discussion of the cases decided in the other English-speaking countries. The statement was made, erroneously we think, in one of the amicus briefs in the *Strassburger* case that "The doctrine that a stock dividend is not income has been adopted throughout the English speaking world." See brief of John E. Hughes, p. 10.

Although not bearing directly upon the meaning of the sixteenth amendment to our Constitution, those cases in general support the view that the word "incomes" in the Sixteenth Amendment is broad enough to include stock dividends.

tioner as a dividend, was taxable if it was 'income' of the kind which the Sixteenth Amendment authorizes Congress to tax." (See record in *Sprouse* case, p. 52, 122 F. (2d) 973, 975.) Similarly, in the *Strassburger* case, Judge Swan, speaking for himself and Judge A. N. Hand, stated that "It is implicit in this provision [Section 115 (f) of the 1936 Act] that Congress intended to tax stock dividends to the full extent of its constitutional power; and so the Regulations expressly declared." (See record in *Strassburger* case, p. 33, 124 F. (2d) 315, 316.) And Judge Chase, who disagreed as to the ultimate result, dissented on the ground that *Eisner* v. *Macomber* forbade the tax rather than upon a ground of statutory construction.[2] Finally, the court below in the instant case rested its decision solely upon *Eisner* v. *Macomber* (R. 14).

I

THE STATUTORY PROVISIONS

1. The stock dividends herein were payable to the stockholders of record at the close of business on May 16 and November 15, 1939, and were dis-

[2] Similarly, in *Dreyfuss* v. *Manning*, 44 F. Supp. 383 (N. J.), a case substantially identical with the *Strassburger* case, the court followed Judge Chase's dissenting opinion and relied solely upon *Eisner* v. *Macomber*. There was not even the remotest suggestion that the statute was too narrowly drawn to reach the dividend if it were income within the meaning of the Constitution.

tributed on June 15 and December 15, 1939, respectively. The operative statutory provisions, therefore, are found in the Internal Revenue Code (53 Stat. 1), for the income tax chapter of the Code was specifically designated (Section 1) to govern the taxable years beginning after December 31, 1938. Section 115 (f) (1) of the Code, however, is identical with Section 115 (f) (1) of the Revenue Act of 1936, involved in the *Strassburger* and *Sprouse* cases. Moreover, since the provisions of Section 115 (f) first appeared in the 1936 Act, their meaning can best be determined by examining them in the setting of the legislative history of that Act.

The revenue bill which became the 1936 Act (H. R. 12395, 74th Cong., 2d Sess.) was introduced and reported to the House of Representatives on April 21, 1936. Prior to that time the scope of *Eisner* v. *Macomber* had been progressively limited in a series of decisions. See *United States* v. *Phellis*, 257 U. S. 156 (Justices McReynolds and Van Devanter dissenting upon the basis of *Eisner* v. *Macomber*); *Rockefeller* v. *United States*, 257 U. S. 176 (same); *Cullinan* v. *Walker*, 262 U. S. 134; *Marr* v. *United States*, 268 U. S. 536 (Justices Van Devanter, McReynolds, Sutherland, and Butler dissenting).[3] And the Court's departure

[3] An apparently temporary trend in the other direction appeared in *Weiss* v. *Stearn*, 265 U. S. 242 (Justices Holmes and Brandeis dissenting), but that trend was soon to be reversed in the *Marr* case, *supra*.

from the theory of *Eisner* v. *Macomber* had been evidenced in a variety of other cases. See (1932) 45 Harv. L. Rev. 1072–1077. See also our brief in the *Strassburger* case, pp. 34–39.

Prior to the 1936 Act, there had been a statutory provision relieving all stock dividends of tax—an exemption which Congress thought had been "required by the decision of the Supreme Court in *Eisner* v. *Macomber*" (H. Rep. No. 350, 67th Cong., 1st Sess., p. 8; S. Rep. No. 275, 67th Cong., 1st Sess., p. 9). The progressive limitation of *Eisner* v. *Macomber*, however, made it clear that so broad an exemption was not necessary. The exemption was accordingly completely eliminated in the 1936 Act. But it was apparent that the process of limitation had not yet ceased, and neither the Treasury nor Congress could know where it would stop. Indeed, *Koshland* v. *Helvering*, 298 U. S. 441, which made further drastic inroads upon the *Macomber* decision, had not yet been decided when the 1936 bill was either introduced or passed by the House.[4] And *Helvering* v. *Gowran*, 302 U. S. 238, which extended the *Koshland* case still further[5] was not to be decided

[4] The *Koshland* case was decided on May 18, 1936. The 1936 bill had already been passed by the House on April 29, 1936. 80 Cong. Rec., part 6, p. 6367.

[5] The *Koshland* case involved a dividend of common stock which was paid to the holders of the preferred and which thereby gave the recipients voting rights not theretofore possessed by them, whereas the *Gowran* case involved a dividend of preferred nonvoting stock which was paid to the common.

until nearly a year and one half after the 1936 Act became law.

Accordingly, Section 115 (f) of the 1936 bill, as introduced and reported to the House, was wisely drafted to be sufficiently flexible to meet all further limitations upon *Eisner* v. *Macomber*. It was framed in the broadest possible terms, and referred to the Sixteenth Amendment itself as marking the limit of its reach. It provided (H. R. 12395, 74th Cong., 2d Sess.):

> (f) STOCK DIVIDENDS.—
>
> (1) GENERAL RULE.—A distribution made by a corporation to its shareholders in stock of the corporation or in rights to acquire stock of the corporation shall be treated as a taxable dividend to the extent that such distribution constitutes income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution and represents a distribution of earnings or profits accumulated after February 28, 1913.

The report of the House Ways and Means Committee left its meaning no less clear. Concisely and unambiguously, the Committee explained these provisions as follows (H. Rep. No. 2475, 74th Cong., 2d Sess., p. 10):

> It is provided in section 115 (f) that stock dividends shall be subject to tax to the extent that such dividends constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution.

This explanation contained no qualification, and did not indicate that the statute was to be read as referring to the Sixteenth Amendment as then interpreted, or as it would be interpreted a few weeks later in the *Koshland* decision, or as it would be interpreted some nineteen months later in the *Gowran* case. It was intended to give this Court a free hand to consider the taxability of any stock dividend as income, unembarrassed by any statutory restriction.

The report of the Senate Finance Committee is equally clear. Although the provisions of Section 115 (f) were restated in the form of a double negative, in an effort to conform to certain changes that were made in Section 115 (a), the critical language was retained ("income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution"), and the Committee plainly stated (S. Rep. No. 2156, 74th Cong., 2d Sess., pp. 18–19):

> This subsection of the House bill, under which stock dividends are made taxable to the full extent permitted by the Constitution, is retained by your committee, except for changes made necessary by virtue of the reported amendment of section 115 (a) and in the interest of greater clarity.

2. The argument that the words "income to the shareholder within the meaning of the Sixteenth Amendment" should not be interpreted to mean

what they say appears to be constructed primarily upon statements made by Mr. Vinson* on the floor of the House. 80 Cong. Rec., part 6, pp. 6214–6215, 6309–6310.

We think that Mr. Vinson's statements, when read in context and in the light of their historical setting, do not require any such disregard of the plain language of the statute or of the clear and carefully prepared explanations of the committees themselves. Mr. Vinson's opening statement explained why the prior exemption of all stock dividends was being eliminated from the statute. He pointed out (p. 6214) that there were "innumerable types" of stock dividends that were constitutionally taxable under *Eisner* v. *Macomber*. However, it must be remembered that most of such dividends were then considered taxable, not because *Eisner* v. *Macomber* recognized them as such, but because of subsequent limitations upon *Eisner* v. *Macomber*. Moreover, the *Koshland* case, which further weakened the *Macomber* decision had not yet been decided by this Court. To be sure, Mr. Vinson declared that the new provisions were not to be regarded (p. 6215) as "an attack upon the Eisner

* It was erroneously stated at the oral arguments of the *Sprouse* and *Strassburger* cases that Mr. Vinson was chairman of the House Ways and Means Committee. Mr. Doughton was the chairman. However, Mr. Vinson was a member of the committee and took an active part in the consideration of the bill.

against Macomber decision." But obviously, all that he meant was that Congress was not *requiring* the taxation of *all* stock dividends in defiance of *Eisner* v. *Macomber;* rather, it was taxing stock dividends to the full extent that they constituted income within the meaning of the Sixteenth Amendment, whatever that extent may be. There was no suggestion that Congress intended to foreclose this Court from reexamining *Eisner* v. *Macomber*. If Congress had so intended, the statute certainly would not have been framed in the specific terms of the Sixteenth Amendment itself. The provisions were designedly drawn in sweeping language with sufficient elasticity to permit the Court to reexamine *Eisner* v. *Macomber,* without at the same time placing Congress in the embarrassing position of making a frontal attack upon the decision. Moreover, the 1936 revenue bill as a whole was the object of vigorous attack by the opposition, and at that time this Court had only recently declared several important Federal statutes unconstitutional; it is therefore easy to see why Mr. Vinson took the pains to explain that he was not sponsoring any unconstitutional legislation. This is confirmed by Mr. Vinson's subsequent colloquy (pp. 6309–6310) with Mr. Treadway, the leader of the opposition, where Mr. Vinson in substance repeated what he had said in his opening statement, and where the

following additional illuminating exchange occurred (p. 6310):[7]

> Mr. TREADWAY. The language now substituted for the stricken language describes new stock dividends that can be taxed or what portion of stock dividends under the sixteenth amendment can in the future be taxed. Is that the right conception of the intention?
>
> Mr. VINSON of Kentucky. Well, *we take the broad position that stock dividends that are taxable income within the sixteenth amendment are subject to taxation,* and if they are not such stock dividends and not any taxable income under the sixteenth amendment, they are not subject to taxes. [Italics supplied.]

We, of course, do not suggest that the Court should not seek every aid in the interpretation

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[7] Similar debates had occurred with respect to the National Labor Relations Act, in which the opponents had argued that the Act would be unconstitutional under recent commerce clause decisions. The sponsors of the Act, however, disavowed any intention to enact unconstitutional legislation; they contended that the Act was designed to go to the limit of the commerce power whatever that limit may be. And this Court has since ruled in *National Labor Relations Board* v. *Fainblatt*, 306 U. S. 601, 607, that the Act represents an exercise of the commerce power to the full extent permissible under the Constitution. Compare *United States* v. *Wrightwood Dairy Co.*, 315 U. S. 110, 121–126, which is even stronger, for the Court ignored contrary statements made by some members of the Senate.

of the statute here involved (cf. *United States* v. *Amer. Trucking Ass'ns*, 310 U. S. 534, 543–544). But we vigorously urge that where the statute is framed in clear terms, and where the reports of the committees of both Houses are equally clear,* the Court should not refuse to give effect to that language merely because there is a statement in the debates which is at most ambiguous and which is as consistent with the plain meaning of the statute as it is with an opposing view.

* In view of the clear language of the statute and the unambiguous intention of Congress, as expressed in the committee reports, there is no room for the application of the rule that statutes should be construed so as to avoid constitutional issues. Compare the remarks of Mr. Justice Cardozo in *Hopkins Savings Assn.* v. *Cleary*, 296 U. S. 315, 334–335:

> Courts have striven mightily at times to canalize construction along the path of safety. *Moore Ice Cream Co.* v. *Rose*, 289 U. S. 373, 379. When a statute is reasonably susceptible of two interpretations, they have preferred the meaning that preserves to the meaning that destroys. *United States* v. *Delaware & Hudson Co.*, 213 U. S. 366, 407; *Knights Templars' Indemnity Co.* v. *Jarman*, 187 U. S. 197, 205; cf. *Illinois Central R. Co.* v. *Public Utilities Comm'n*, 245 U. S. 493, 510; *Savage* v. *Jones*, 225 U. S. 501, 533. "But avoidance of a difficulty will not be pressed to the point of disingenuous evasion." *Moore Ice Cream Co.* v. *Rose*, *supra*. "Here the intention of the Congress is revealed too distinctly to permit us to ignore it because of mere misgivings as to power." *Ibid.* The problem must be faced and answered.

3. There is no more reason to read *Eisner* v. *Macomber* as a gloss upon the broad language of Section 115 (f) than there was to read *Collector* v. *Day*, 11 Wall. 113, as a limitation upon the general language in Section 22 (a) of the revenue acts which defined gross income as including "income derived from salaries, wages, or compensation for personal service." And there was never any serious dispute that Section 22 (a) was not sufficiently sweeping to encompass any restrictions upon the decision of *Collector* v. *Day* (cf. *Helvering* v. *Gerhardt*, 304 U. S. 405), or indeed, the overruling of *Collector* v. *Day*. Thus, after the *Gerhardt* decision, when the overruling of *Collector* v. *Day* appeared imminent in *Graves* v. *N. Y. ex rel O'Keefe*, 306 U. S. 466, which was then pending, Congress found it necessary to enact legislation (Public Salary Tax Act of 1939, 53 Stat. 574) which would relieve state employees from the hardship involved in the retroactive application of the new decision.*

Moreover, although the Public Salary Tax Act also amended Section 22 (a) prospectively by inserting after the words "compensation for personal service" the following: ("including personal service as an officer or employee of a State * * *"), it did so only out of an abun-

* The Treasury expects to propose similar legislation here if *Eisner* v. *Macomber* is overruled. See *infra*, p. 55.

dance of caution. Thus, the report of the House Ways and Means Committee plainly stated (H. Rep. No. 26, 76th Cong., 1st Sess., pp. 3–4):

> Section 1: Section 1 of the bill amends section 22 (a) of the Revenue Act of 1938 (which defines gross income) by providing expressly that there shall be included in gross income, salaries, wages, or compensation for "personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing." Under this amendment the wages, salaries, and compensation of all officers and employees of the respective States and of their political subdivisions and agencies and instrumentalities, without exception, are included in gross income. *The committee recognizes that the language of section 22 (a) as it previously existed was broad enough to include in gross income the compensation of such officers and employees.* The Treasury Department, however, believing the compensation of some of these officers and employees to be constitutionally exempt has, until recently, by administrative action treated their compensation as nontaxable. This administrative action, followed by repeated reenactment of the statutory provisions without change, might lead to the contention that Congress by such reenactment had exempted such State and local officers and employees. This contention would only serve to con-

> fuse the issue of the constitutionality of the future taxation of all State and local officers and employees. To eliminate the possibility of such confusion, therefore, your committee recommends amendment of the Revenue Act of 1938 to insert the proposed language so that there can be no doubt whatever of the intention of Congress that all State and local officers and employees, without exception, shall be subject to Federal income tax for taxable years beginning after December 31, 1938. It is not to be inferred from this amendment, however, that those groups of State and local officers and employees from whom Federal income taxes have previously been collected were not subject to tax under the language of section 22 (a) in earlier revenue acts or in the Revenue Act of 1938 as it existed prior to the amendment proposed in the bill. [Italics supplied.]

See also S. Rep. No. 112, 76th Cong., 1st Sess., pp. 10–11.

4. The contention was made in one of the amicus briefs in the *Strassburger* case that legislation which seeks the limits of constitutional power is vague and undesirable and that therefore this Court should give it a narrower interpretation. However, statutory provisions of this type are not at all unfamiliar and the Court has given full effect to such legislation in situations that are far more dramatic and sweeping than the present case.

In *United States* v. *Wrightwood Dairy Co.*, 315 U. S. 110, the Court held that in the agricultural legislation there involved Congress had intended to exercise its power to the full extent permissible under the Constitution. It will be recalled that the agricultural legislation was pending in Congress when *Schechter Corp.* v. *United States*, 295 U. S. 495, was decided; and that there was substituted in place of the broad language of the pending bill language regarded as more restrictive in the light of the *Schechter* opinion, which reflected a more limited view of the commerce clause. Nevertheless, this Court held in the *Wrightwood* case that the statute was intended to go the whole way and was not to be limited by the concepts of commerce set forth in the *Schechter* opinion whence the statutory language was derived.[10]

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[10] To be sharply distinguished from the present case as well as the *Wrightwood* case is *Parker* v. *Motor Boat Sales*, 314 U. S. 244. In a doubtful and probably erroneous decision, *Southern Pacific Co.* v. *Jensen*, 244 U. S. 205, it had been held that a state was without constitutional authority to enact certain workmen's compensation legislation with respect to a stevedore engaged in work of a maritime nature upon navigable waters within the state. The basis of the decision was that the Constitution had committed exclusive jurisdiction over such matters to the national government. Although Congress was not anxious to enter the field, it nevertheless thereafter enacted like legislation for the benefit of the employees and their families, but provided that the Act was to be applicable only if recovery through workmen's compensation proceedings "may not validly be provided by State law." The widow and children of a deceased employee

Similarly, the National Labor Relations Act became law at a time when the commerce clause had received a narrow interpretation. Yet the Court recognized that it was framed in sufficiently broad terms to constitute an exercise of the commerce power to the full extent of the Constitution. *National Labor Relations Board* v. *Fainblatt*, 306 U. S. 601, 607.

Indeed, the present case is stronger, for here the statute makes specific reference to the Constitution itself.

Even more sweeping are the provisions of the so-called civil rights statute which penalizes a conspiracy to injure, oppress, or intimidate any citizen "in the free exercise or enjoyment of any right or privilege secured to him by the Constitution or laws of the United States". U. S. C., Title

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sought compensation under the federal Act in the *Motor Boat Sales* case; it was argued in opposition to their claim that the statute did not apply because the *Jensen* case had been erroneously decided and compensation could "validly be provided by State law." To have accepted that contention, however, would have meant that the very object which Congress sought to attain—namely, the protection of the employees and their families—would have been defeated in that case. The Court accordingly gave effect to the dominant purpose of Congress by construing the word "validly" as meaning within constitutional limits as then recognized by existing decision.

No such considerations are present here. No congressional purpose would be furthered by any such interpretation of this statute, which seeks to expand the taxing power over stock dividends to the full extent permitted by the Sixteenth Amendment.

18, Sec. 51. See *Motes* v. *United States*, 178 U. S. 458, 462. Again, there are a large number of federal crimes which are so defined as to include only acts committed "upon the high seas, or on any other waters within the admiralty and maritime jurisdiction of the United States." See U. S. C., Title 18, Secs. 451, 482, 483, 484, 487, 489, 490, 491, 492, 497. These statutes make applicable two constitutional provisions: Article I, Sec. 8, cl. 10, dealing with crimes on the "high seas," and Article III, Sec. 2, extending federal judicial power to all cases of "admiralty and maritime Jurisdiction."

Finally, as recently as this year, the Court stated in the saboteur cases (*Ex parte Quirin*, opinion dated October 29, 1942, pp. 8–9):

> By the Articles of War, and especially Article 15, Congress has explicitly provided, so far as it may constitutionally do so, that military tribunals shall have jurisdiction to try offenders or offenses against the law of war in appropriate cases. * * *

Thus, that legislation, with its severe penalties, called into play the entire sweep of constitutional power as well as that nebulous field, the "law of war."

II

THE TREASURY REGULATIONS

1. This case involves the taxable year 1939, the returns for which were due on March 15, 1940.

The *only* Treasury regulations applicable to the year 1939 are Regulations 103, which were promulgated on January 29, 1940. The provisions relating to stock dividends are contained in Section 19.115–7, the first sentence of which reads as follows:

> SEC. 19.115–7. *Stock dividends.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend *to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution.* * * * [Italics supplied.]

As originally issued, this sentence was followed by a discussion (taken largely from the opinion in the *Koshland* case) as to what this Court had ruled in the past with respect to the scope of the Sixteenth Amendment; and that discussion was in turn followed by three examples which represented the holdings of this Court in three decisions, namely, (1) the *Koshland* case, (2) *Eisner* v. *Macomber,* and (3) *Helvering* v. *Gowran,* 302 U. S. 238.

On November 15, 1940, less than ten months after Regulations 103 had been promulgated, the Commissioner of Internal Revenue and the Secretary of the Treasury, by T. D. 5020, 1940–2 Cum. Bull. 118, amended Section 19.115–7, striking out all of the matter appearing after the first sentence, quoted above. To the extent that this amendment had any significance, it applied to the year 1939

(the first year governed by Regulations 103) as well as to subsequent years, for Section 3791 (b) of the Code specifically provides:

> SEC. 3791. RULES AND REGULATIONS
>
> * * * * *
>
> (b) RETROACTIVITY OF REGULATIONS OR RULINGS.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe *the extent, if any,* to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect. [Italics supplied.]

Thus, these provisions make it clear beyond question that the new regulations are to have universal application, both prospective and retrospective,[11] *unless* the Secretary of the Treasury or the Commissioner has prescribed that they may operate without retroactive effect. But neither the Secretary nor the Commissioner has so prescribed with respect to this amendment, and we do not understand respondent to contend the contrary.

[11] Normally, even if an amendment in any particular regulations were permitted to be fully retroactive, it could affect liability for only a very few tax years. For there is generally a separate set of regulations with respect to each revenue act, and since each revenue act governs liability for at most only several years, the amendment of any Treasury regulations would not reach back of the revenue act under which they were issued. Moreover, the three-year statute of limitations (see Section 275 of the Code) would in any event operate as an outside limit for the reopening of liability with respect to past years.

The history of the foregoing provisions of Section 3791 (b) is illuminating, and is set forth in detail in Appendix C, *infra*, pp. 48–55.

2. Although we think that the regulations should be considered only as amended, we submit that even in their original form they do not foreclose the reexamination of *Eisner* v. *Macomber*.

The original regulations were of a unique character, unlike any which this Court has had occasion to consider. They consisted essentially of three parts. Only the first part, the first sentence, purported to be an interpretation of the statute, and it declared that a stock dividend "shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution." The second part consisted of a discussion, not of the statute, but of constitutional principles, and was prefaced by a sentence reading "The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the meaning of the Constitution." At that point there was a footnote, citing a number of decisions, and the sentence was then followed by a discussion that was taken largely from the *Koshland* opinion. Nowhere in this discussion was there any indication that the Treasury was doing anything more than attempting to restate the constitutional principles expounded in the decided cases; and nowhere did it

indicate that the Treasury *construed* the statute more narrowly than the Constitution itself. The third and final part of these regulations consisted simply of three examples which in substance merely stated the holdings of the *Koshland, Macomber* and *Gowran* cases, respectively, without specifically identifying them.

Accordingly, even if the second and third parts of these regulations, which had been eliminated, are taken into account, they represented simply an effort by the Treasury to set forth the principles of decided cases—principles of constitutional law, and not an interpretation of the statute. This case is therefore much stronger than the analogous situation in *Helvering* v. *Hallock*, 309 U. S. 106, 121, n. 8, where the Court held that the Treasury was not bound by regulations which it had promulgated under the compulsions of certain earlier decisions and which did not in fact represent its interpretation of the statute. The situation here is stronger, because the regulations herein, apart from the first sentence, did not even purport to be an interpretation of Congressional intent. Finally, to the extent that these regulations might otherwise apply to prevent the imposition of the tax they are invalid. Cf. *Helvering* v. *Gerhardt*, 304 U. S. 405, 422–423.

III

THE IMPORTANCE OF OVERRULING EISNER *v.* MACOMBER

In our brief in the *Strassburger* case we undertook to demonstrate at length that *Eisner* v. *Macomber* was erroneously decided; and in Points I and II of this brief we have endeavored to show that the question is squarely presented here, that the statute was carefully framed so as to impose the tax if the dividend constituted income within the meaning of the Sixteenth Amendment, and that the regulations do not stand in the way. We think that there can be no serious question as to whether the issue is squarely raised. Moreover, there are considerations of great public importance which require that *Eisner* v. *Macomber* be reexamined.

The importance of overruling *Eisner* v. *Macomber* is not merely that the Government may be able to tax stock dividends, although many millions of dollars in taxes may be involved each year with respect to stock dividends. Of far greater importance is the removal of the restriction that it imposes upon the taxation of corporate earnings in the hands of the shareholders at the appropriate surtax levels.

In the Civil War income tax law, corporate earnings were taxed directly to the stockholders, whether or not the earnings were in fact distributed to them, just as though they were mem-

bers of a partnership. *Collector* v. *Hubbard*, 12 Wall. 1. And to a limited extent after the adoption of the Sixteenth Amendment, Congress attempted to tax stockholders directly with respect to corporate earnings where the corporation was used for the purpose of avoiding surtax.[12] But it was thought that such provisions could not survive *Eisner* v. *Macomber*, for in ruling that stock dividends based upon corporate earnings could not be taxed the majority opinion stated the essense of its holding as follows (252 U. S. at 211):

> The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. * * *

This did not appear to be mere obiter dicta, particularly since the Court further stated (252 U. S. at 217–219) that *Collector* v. *Hubbard* must be regarded as overruled. The very heart of decision seemed to be that there could be no "in-

[12] See Section 220 of the Revenue Act of 1918, 40 Stat. 1057; Section 3 of the Revenue Act of 1916, 39 Stat. 756; Section II, A, subdivision 2, of the Revenue Act of 1913, 38 Stat. 114, 166–181.

come" constitutionally to the stockholders with respect to the earnings of their corporation until those earnings were distributed. Accordingly, as a result of *Eisner* v. *Macomber*, Congress promptly repealed the tax upon the stockholders,[12] and the reason for the change was noted by the committees of both Houses. See H. Rep. No. 350, 67th Cong., 1st Sess., pp. 12–13:

SURTAX EVASION BY CORPORATE ORGANIZATION

Section 226: Section 220 of the existing law provides that if any corporation is formed or availed of for the purpose of evading the surtax upon its stockholders through the medium of permitting its gains and profits to accumulate instead of being divided, the stockholders shall be taxed in the same manner as partners. By reason of the recent decision of the Supreme Court in the stock dividend case (*Eisner* v. *Macomber*, 252 U. S., 189), considerable

[12] In place of these provisions there were substituted less satisfactory provisions which imposed an artificial flat rate penalty tax upon the corporation itself where it had been formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders. See Section 220 of the Revenue Act of 1921, 42 Stat. 227; Section 220 of the Revenue Act of 1924, 43 Stat. 253; Section 220 of the Revenue Act of 1926, 44 Stat. 9; Section 104 of the Revenue Act of 1928, 45 Stat. 791; Section 104 of the Revenue Act of 1932, 47 Stat. 169; Section 102 of the Revenue Act of 1934, 48 Stat. 680; Section 102 of the Revenue Act of 1936, 49 Stat. 1648; Section 102 of the Revenue Act of 1938, 52 Stat. 447; Section 102 of the Internal Revenue Code, 53 Stat. 1.

doubt exists as to the constitutionality of the existing law. * * *

See also S. Rep. No. 275, 67th Cong., 1st Sess., p. 16.

Of even greater significance, however, than the corporations availed of for the *purpose* of preventing the imposition of surtaxes, was the great mass of business corporations generally which in their normal operations distributed only a portion of their earnings as dividends, with the result that the remaining earnings would escape surtax in the hands of the stockholders. Growing concern over the situation led the President to send a special message to Congress in 1936 (see House Doc. No. 418, 74th Cong., 2d Sess.), in which he declared (pp. 2–3):

> The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, as a matter of fundamental equity, should be to seek equality of tax burden on all corporate income whether distributed or withheld from the beneficial owners. As the law now stands our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends, while the shares of stockholders who can afford to leave

earnings undistributed escape current surtaxes altogether.

This method of evading existing surtaxes constitutes a problem as old as the income tax law itself. Repeated attempts by the Congress to prevent this form of evasion has not been successful. The evil has been a growing one. It has now reached disturbing proportions from the standpoint of the inequality it represents and of its serious effect on the Federal revenue. Thus the Treasury estimates that, during the calendar year 1936, over 4½ billion dollars of corporate income will be withheld from stockholders. If this undistributed income were distributed, it would be added to the income of stockholders and there taxed as is other personal income. But, as matters now stand; it will be withheld from stockholders by those in control of these corporations. In one year alone, the Government will be deprived of revenues amounting to over $1,300,000,000.

In order to meet in part that staggering loss of revenue the President recommended the repeal of existing corporate taxes and the imposition of an undistributed profits tax. The undistributed profits tax could not fully meet the deficiencies of existing law, but it would succeed to the limited extent that it would induce distributions of corporate earnings which would then be taxed at the appropriate surtax levels, leaving the remaining

earnings to be reached by the undistributed profits tax itself.[14]

It is not unreasonable to suppose that it was thought that *Eisner* v. *Macomber* prevented the adoption of a much more complete and less circuitous solution, namely the imposition of a tax directly upon the stockholders with respect to their pro rata share of corporate earnings, whether or not distributed to them.[15] But in any event the hearings and debates upon the 1936 revenue bill show that such fears of unconstitutionality, engendered by *Eisner* v. *Macomber*, foreclosed that alternative as a possible solution.

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[14] The new system proposed by the President apparently would not close the gap completely, for his estimate that the new taxes would produce $620,000,000 additional revenue (p. 3) should be contrasted with his statement that the Government would lose over $1,300,000,000 in one year under the old system.

[15] A direct tax upon stockholders has been successfully employed to a considerable extent in various foreign countries, notably Australia. See Proceedings, National Tax Association, 1939, p. 548. Moreover, the Final Report of the Committee of the National Tax Association on Federal Taxation of Corporations recommended that the partnership method be applied to the taxation of corporate earnings to the limit of its legal and administrative possibilities; and it was stated that "the number of corporations to which the partnership method can be applied without involving formidable administrative difficulties is far greater than is generally realized". *Id.*, pp. 555, 579–580.

But the Committee was careful to note the constitutional doubts which would be raised by such a method of taxing corporate earnings, and indeed recommended that the Constitution be amended, if that should be necessary. *Id.*, pp. 548, 579.

Thus, in the Senate debates upon the undistributed profits tax, the following occurred (80 Cong. Rec., part 8, p. 8813):[18]

> Mr. ADAMS. Mr. President, is it possible from a legal and administrative standpoint to assimilate the tax procedure applicable to corporations as is done in the case of a partnership?
>
> Is it legally possible to say to each corporation, "Make a report of the proportionate earnings of each stockholders", as we would to a partnership, and then let the stockholder make his return?
>
> Mr. BLACK. Unfortunately that was done about 60 years ago, and while it is my recollection that the Supreme Court itself sustained the act [presumably referring to *Collector* v. *Hubbard*, 12 Wall. 1], it later, by another divided opinion [presumably referring to *Eisner* v. *Macomber*], changed its mind and struck down the act as being in contravention of the Constitution. So that it is impossible to tax the undistributed profits which remain in the corporate treasury as a part of the individual incomes of the stockholders.

Similarly, in the Hearings of the House Ways and Means Committee on the 1936 revenue bill, Rep-

[18] In the Hearings on the 1936 revenue bill the Senate Finance Committee was told by a tax expert that "our constitution says that we cannot tax individuals upon the undistributed profits of their corporations." P. 255. Cf. p. 696. See also Proceedings, National Tax Association, 1939, pp. 548, 555.

resentative David J. Lewis of Maryland stated (p. 193):

> Mr. LEWIS. I do not know that it is fully understood by the public that this roundabout device of compelling the distribution of the real income of the corporation to its shareholders, so that the shareholders may be called upon to pay taxes upon their income, is due to a decision of a divided court. Some years ago the Supreme Court in a sharp decision determined that we could not do in the United States with regard to earned dividends that were not distributed what they do in other countries, especially in England, require the shareholder to pay his tax on his income just the same whether his company had refused to distribute it or not.
>
> Now, if that decision [17] of the Court should be reversed, what we are doing here, or attempting to do in order to reach the taxpayer here, the method of our attempt, would not be necessary. Not ours the fault of all this clumsiness and indirection of approach to a necessary public object.

See also pp. 96, 98, 321, 322, 340, 341, 745.

Whether it was rightly or wrongly thought that *Eisner* v. *Macomber* prevented such a system of taxation, the fact is that the very existence of

[17] In a letter subsequently written to the editors of the University of Pennsylvania Law Review, Representative Lewis confirmed the fact that he was referring to *Eisner* v. *Macomber*. See 85 U. of Pa. L. Rev. 83, 86, n. 17.

Eisner v. *Macomber* rules out such a tax as a practical matter, for it is obvious that, unlike other types of legislation, no system of taxation may be deliberately adopted as a major part of our fiscal scheme so long as there exists doubt as to its ultimate fate in the courts.

Moreover, even if Congress should again prefer to tackle the problem in whole or in part through the undistributed-profits tax, *Eisner* v. *Macomber* stands in the way of a suitable statute. The 1936 undistributed-profits tax, as enacted, was the source of widespread dissatisfaction and irritation. There were countless complaints that corporations were being forced into making distributions of assets that were unsound from a business point of view, in order to avoid the rigors of the undistributed-profits tax. However, if *Eisner* v. *Macomber* did not block the way, stock dividends could be declared against the earnings in such manner that there would be no disturbance of the corporate structure.[18] Accordingly, a far more workable and satisfactory undistributed-profits tax could be achieved if *Eisner* v. *Macomber* were

[18] Of course, stock dividends of the *Koshland* type would not involve any distribution of corporate assets, but the scope of the *Koshland* case itself was too uncertain (for example, its applicability is now being vigorously contested in the *Sprouse* and *Strassburger* cases); and in any event such dividends might involve an unsound dislocation of the corporate framework. See Proceedings, National Tax Association, 1939, pp. 549, 550, 555–558.

overruled. And particularly at this time, when the maximum revenues are needed by the Government and when it becomes of even greater importance that additional taxes be imposed as equitably as possible, neither the Treasury nor Congress should be straight-jacketed in the formulation of new legislation by an erroneous constitutional decision of sweeping dimensions.

CONCLUSION

The judgment below should be reversed.

Respectfully submitted.

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DECEMBER 1942.

APPENDIX A

Constitution of the United States:

Article I, Section 2, Clause 3.—Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons * * *.

Article I, Section 8, Clause 1.—The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

* * * * *

Article I, Section 9, Clauses 4 and 5.—No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

No Tax or Duty shall be laid on Articles exported from any State.

* * * * *

Sixteenth Amendment.—The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Internal Revenue Code (53 Stat. 1):

SEC. 1. APPLICATION OF CHAPTER.

The provisions of this chapter shall apply only to taxable years beginning after December 31, 1938. Income, war-profits, and excess-profits taxes for taxable years beginning prior to January 1, 1939, shall not be affected by the provisions of this chapter, but shall remain subject to the applicable provisions of the Revenue Act of 1938 and prior revenue acts, except as such provisions are modified by legislation enacted subsequent to the Revenue Act of 1938.

SEC. 22. GROSS INCOME.

(a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from * * * dividends * * *.

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) DEFINITION OF DIVIDEND.—The term "dividend" when used in this chapter (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) SOURCE OF DISTRIBUTIONS.—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

* * * * *

(f) STOCK DIVIDENDS.—

(1) GENERAL RULE.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) ELECTION OF SHAREHOLDERS AS TO MEDIUM OF PAYMENT.—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend

in the hands of all shareholders, regardless of the medium in which paid.

* * * * * *

(j) VALUATION OF DIVIDEND.—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

* * * * * *

Treasury Regulations 103, promulgated January 29, 1940, under the Internal Revenue Code:

SEC. 19.115–7 [as amended by T. D. 5020, 1940–2 Cum. Bull. 118, issued November 15, 1940]. *Stock dividends.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution.

The amendment made by T. D. 5020 consisted simply of the *addition* of the following material which had previously followed the sentence quoted above:

The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the meaning of the Constitution.[1] The dis-

[1] See *Eisner* v. *Macomber* (252 U. S., 189, T. D. 3010, C. B. 3, 25 (1920)); *Koshland* v. *Helvering* (298 U. S., 441, Ct. D. 1124, C. B. XV–1219 (1936)); *Helvering* v. *Gowran* (302 U. S. 238, C. B. 1938–1, 340); and *Helvering* v. *Pfeiffer* (302 U. S., 247,

tinction between a stock dividend which does not, and one which does, constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution is the distinction between a stock dividend which works no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and a stock dividend where there either has been a change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholder after the distribution is essentially different from his former interest. A stock dividend constitutes income if it gives the shareholder an interest different from that which his former stock holdings represented. A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old.

Example (1): The X Corporation had an authorized capital stock of $300,000 of common stock, par value $10 a share, and $100,000 of 7 percent cumulative preferred stock, par value $100 a share, which is preferred as to dividends, has no voting rights, and may be redeemed at any time at $105

C. B. 1938-1, 304). Compare *United States* v. *Phellis* (257 U. S., 156, T. D. 3270, C. B. 5, 37 (1921)); *Rockefeller* v. *United States* (257 U. S., 176, T. D. 3271, C. B. 5, 34 (1921)); *Cullinan* v. *Walker* (262 U. S., 134, T. D. 3508, C. B. II-2, 55 (1923)); *Weiss* v. *Stearn* (265 U. S., 242, T. D. 3609, C. B. III-2, 51 (1924)); and *Marr* v. *United States* (268 U. S., 536, T. D. 3755, C. B. IV-2, 116 (1925)).

per share. The articles of incorporation provide that the annual dividend on the preferred stock may be paid in cash or, at the option of the corporation, in one share of common stock for each share of preferred. On July 1, 1939, the X Corporation had outstanding $200,000 of common stock and $100,000 of preferred stock, earnings and profits of $60,000 accumulated since February 28, 1913, and earnings and profits of the taxable year amounting to $15,000. On July 1, 1939, it distributed 1,000 shares of its common stock of an aggregate par value (and fair market value) of $10,000 to the holders of its preferred stock in payment of the annual dividend on such stock. The stock so distributed constitutes a taxable stock dividend to the holders of the preferred stock.

Example (2): On July 1, 1939, the Y Corporation had an authorized capital stock consisting of 1,000 shares of common stock, par value $100 a share, of which 500 shares were outstanding. It had earnings and profits of $40,000 accumulated since February 28, 1913, and $5,000 of earnings and profits of the taxable year. On July 1, 1939, the Y Corporation issued and divided among its shareholders 250 additional shares of its common stock of a total par value of $25,000 and transferred an equivalent amount from surplus account to capital stock account. The stock so distributed does not constitute a taxable stock dividend to the shareholders.

Example (3): The Z Corporation had an authorized capital stock of 30,000 shares of common, without par value, and 10,000 shares of 7 percent cumulative preferred stock, par $100, which is p[illegible]rred as to

dividends, has voting rights, and may be redeemed on the 1st of January or July of any year by the payment of $105 per share and accrued dividends. On July 1, 1939, the company's issued and outstanding stock amounted to 20,000 shares of common and 6,000 shares of preferred, and it had $250,000 earnings and profits accumulated since February 28, 1913, and $90,000 earnings and profits of the taxable year. On July 1, 1939, it paid a dividend on its common stock in preferred stock at the rate of 1/10 share of preferred on each share of common outstanding. The preferred stock so distributed constitutes a taxable stock dividend to the holders of common stock.

APPENDIX B

THE TAXABILITY OF STOCK DIVIDENDS IN OTHER ENGLISH-SPEAKING COUNTRIES

The decisions in other English-speaking jurisdictions are not directly illuminating upon the construction to be accorded the Sixteenth Amendment to our Constitution. However, the light which they do throw upon the question supports our contention that the word "incomes" in the Sixteenth Amendment is broad enough to include stock dividends.

Canada.—In Canada the statute expressly includes stock dividends within the tax upon the receipt of dividends, and these provisions have been applied to common-on-common stock dividends by the Exchequer Court of Canada. *The King* v. *Johnson Matthey & Co.*, [1938] Ex. C. R. 141.

South Africa.—In South Africa the statute includes as income subject to super tax "an amount equal to the nominal value of any bonus shares, debentures or other securities awarded to the taxpayer by way of capitalizing the profits of a company * * *" This provision was applied to include stock dividends in *Liddell* v. *Commissioner for Inland Revenue* (1939), So. Afr. L. R. (Cape of Good Hope Provincial Division) 161.

Australia.—Stock dividends are also treated as income in Australia. *Swan Brewery Co.* v. *The*

King, [1914] A. C. 231, involved a statute of Western Australia which levied a tax upon every company declaring a dividend, the term "dividend" being defined as including "every profit, advantage, or gain intended to be paid or credited to or distributed among" the members of the company. The Supreme Court of Western Australia held that a common-on-common stock dividend was subject to the tax and its judgment was affirmed by the Privy Council.

James v. *Federal Commissioner of Taxation*, 34 Commw. L. R. 404 (High Court of Australia 1924) involved a statute which provided that "The income of any person shall include * * * dividends, interest, profits, or bonus credited or paid to any depositor, member, or shareholder." The taxpayer was a shareholder of a corporation which distributed partly paid-up common shares as a dividend upon its outstanding stock, which consisted solely of common shares. It was held that the partly paid-up shares constituted income *pro tanto* within the meaning of the statute.

A similar result was reached in *Nicholas* v. *Commissioner of Taxes of the State of Victoria*, [1940] A. C. 744, in which the Privy Council sustained a judgment of the High Court of Australia (59 Commw. L. R. 230) that a common-on-common stock dividend was taxable as income under a statute of Victoria similar to that considered in the *James* case.

The Australian Income Tax Assessment Act, 1936–1940, No. 17 of 1940, now defines a dividend to include (sec. 6) "the paid-up value of shares distributed by a company to its shareholders to

the extent to which the paid-up value represents a capitalization of profits."

England and India.—The question was considered under the English Act in *Commissioners of Inland Revenue* v. *Blott*, [1921] 2 A. C. 171, in which a bare majority of the House of Lords held a stock dividend to be not taxable. The decision has been regarded as turning, however, upon the point that a stock dividend was not a *payment* by the corporation within the meaning of the statutory phrase, "rents, interests, annuities or other annual payments * * * "[1] See the opinions of Isaacs, J., in *James* v. *Federal Commissioner of Taxation, supra*, pp. 413–416, and of Lord Thankerton in *Nicholas* v. *Commissioner of Taxes of the State of Victoria, supra*, pp. 755–758. Thus, even dividends of preferred stock (see the *Blott* case, *supra*) and of debentures (*Commissioners of Inland Revenue* v. *Fisher's Executors*, [1926] A. C. 395 (House of Lords)) do not fall within the meaning of that statutory provision. The same results have been reached under the Indian Act which is similar to the English Act upon this point. *Commissioner of Income-Tax, Bengal* v. *Mercantile Bank of India, Ltd.*, [1936] A. C. 478 (House of Lords).

The significant consideration with respect to all of the foregoing cases is that stock dividends were treated as taxable income where the statute was properly framed. For, as the *James* and *Nicholas* cases plainly indicate, the *Blott* case and

[1] The statutory provisions are set out in the opinions in the Court of Appeal, [1920] 2 K. B. 657, 668, and of Rowlatt, J., [1920] 1 K. B. 114, 115, 132.

its progeny do not stand in the way of including stock dividends within taxable income if the statute is properly drawn. And equally significant for present purposes is the fact that the legislatures of most of the English-speaking jurisdictions have treated stock dividends as income. Thus, when it is sought to tax "income," stock dividends are thought of as naturally falling into that category along with other kinds of income. We submit that this shows that the ordinary meaning of the word "income" is broad enough to include stock dividends. And, as we pointed out in our brief in the *Strassburger* case (p. 22–23), the Sixteenth Amendment, like every other constitutional provision, should be broadly interpreted so as to give Congress whatever power can reasonably be read into its terms. To deny to Congress, as did *Eisner* v. *Macomber*, the power to treat stock dividends as income—a power found necessary of exercise by the majority of the other English-speaking jurisdictions in the development of a sound system of progressive income taxation—is to construe the Sixteenth Amendment in direct violation of its purpose.

APPENDIX C

RETROACTIVE REGULATIONS

The plenary power to prescribe the extent to which any ruling, regulation, or Treasury Decision may operate with[1] or without retroactive effect is plainly recognized by Section 3791 (b) of the Internal Revenue Code (53 Stat. 1) which provides:

> SEC. 3791. RULES AND REGULATIONS.
>
> * * * * * *
>
> (b) RETROACTIVITY OF REGULATIONS OR RULINGS.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

The first comparable statutory provisions were of a more limited character, and appeared in the Revenue Act of 1921, 42 Stat. 227. Section 1314 of that Act provided:

RETROACTIVE REGULATIONS

> SEC. 1314. That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with

[1] For decisions involving retroactive application of regulations, see *Morrissey* v. *Commissioner*, 296 U. S. 344, 355; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299; *Manhattan Co.* v. *Commissioner*, 297 U. S. 129.

> the approval of the Secretary, is reversed by a subsequent regulation or Treasury Decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

In commenting upon those provisions (referred to as Sec. 1002 in the House bill), the House Ways and Means Committee stated (H. Rep. No. 350, 67th Cong., 1st Sess., p. 15):

> Section 1002 would permit the Treasury Department to apply without retroactive effect a new regulation or Treasury decision reversing a prior regulation or Treasury decision, unless such reversal is occasioned or required by a decision of a court of competent jurisdiction.

And the Senate Finance Committee similarly remarked (S. Rep. No. 275, 67th Cong., 1st Sess., p. 32):

> Section 1314 of the proposed bill authorizes the commissioner, with the approval of the Secretary, to provide in making a regulation or Treasury decision which reverses a prior regulation or Treasury decision (if it is not immediately occasioned by a decision of a court of competent jurisdiction) that the new regulation or Treasury decision may be applied without retroactive effect.

Thus, it was clear that under the 1921 Act, any change in the regulations was to operate

retrospectively as well as prospectively, unless the Treasury determined to permit the change to operate prospectively only. But where the change in regulations was occasioned by judicial decision the Treasury was to have no discretion; such change was to affect all tax years, both before and after the change.

The next revenue act, the Revenue Act of 1924, 43 Stat. 253, made no change in these provisions which were embodied in Section 1008 (a) of that Act. Thereafter, the same provisions were carried over as Section 1108 (a) of the Revenue Act of 1926, without any alteration. However, Section 605 of the Revenue Act of 1928, 45 Stat. 791, amended Section 1108 (a) of the 1926 Act as follows:

> SEC. 605. RETROACTIVE REGULATIONS.
>
> Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:
>
> "SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect."

The purpose of the amendment was to increase further the discretion given to the Treasury. It was intended to permit the Treasury to determine whether a change in regulations should operate prospectively only, even where the change was induced by judicial decision. This was made abundantly clear by the Senate Finance Committee

which stated (S. Rep. No. 960, 70th Cong., 1st Sess., p. 40):[2]

> Section 1108 (a) of the revenue act of 1926 provides that where a regulation or Treasury decision is reversed by a subsequent regulation or Treasury decision, the subsequent decision may be applied without retroactive effect if the reversal is not immediately occasioned or required by a court decision. The policy of this provision is highly desirable, and in view of the fact that the Bureau of Internal Revenue is now comparatively free from the congestion of cases from the war years, it is believed that this policy may now be extended to cases where the new regulation or Treasury decision is occasioned or required by a court decision. Fundamentally there is no difference in the two cases which can justify the restrictions in section 1108 (a) of the 1926 act. Accordingly, these restrictions have

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[2] In accepting the Senate amendment, the Conference Committee declared (H. Rep. No. 1882, 70th Cong., 1st Sess., p. 22):

"* * * Section 1108 (a) of the revenue act of 1926 permits the commissioner to apply a new regulation or Treasury decision without retroactive effect when the new regulation or Treasury decision is not immediately occasioned by a court decision.

"This desirable policy has been extended by the Senate amendment so as to include all regulations and Treasury decisions whether or not occasioned by a court decision. It is hoped that this provision will prevent the constant reopening of cases on account of changes in regulations or Treasury decisions, and it is believed that sound administration properly places upon the Government the responsibility and burden of interpreting the law and of prescribing regulations upon which the taxpayers may rely; and the House recedes."

> been removed in section 605 of the bill. * * *

The final change wrought in these provisions appeared in Section 506 of the Revenue Act of 1934, 48 Stat. 680, which amended Section 1108 (a) of the 1926 Act to read:

> (a) The Secretary, or the Commissioner with the approval of the Secretary, may prescribe *the extent, if any,* to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect. [Italics supplied.]

The discretion vested in the Treasury was now complete. The Treasury could determine not only whether changes in regulations were to be retrospective in all cases, but it was given the further power of declaring the exact extent of retroactivity. Thus, under the new provisions, the Treasury might provide for a change in regulations that would operate retroactively for any designated period. The committee reports leave no doubt whatever that this was the purpose of these provisions. The House Ways and Means Committee unambiguously explained the amended provisions as follows (H. Rep. No. 704, 73d Cong., 2d Sess., p. 38):

> This section amends section 1108 (a) of the Revenue Act of 1926, as amended, so as to permit the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal revenue taxes shall be applied without retroactive effect.

> The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. *Regulations, Treasury Decisions, and rulings which are merely interpretative of the statute, will normally have a universal application, but in some cases the application of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only.* [Italics supplied.]

A similar statement was made by the Senate Finance Committee. S. Rep. No. 558, 73d Cong., 2nd Sess., p. 48.

These provisions, as thus amended by the 1934 Act were incorporated into the Internal Revenue Code as Section 3791 (b) which is involved herein. The history of these provisions plainly shows, we submit, that Congress intended the Treasury to have full and complete discretion to determine to what extent changes in regulations are to operate

retroactively. Nowhere in the legislative history is there the slightest suggestion that the Treasury's discretion was to be limited, in the language of *Helvering* v. *Reynolds Tobacco Co.*, 306 U. S. 110, 116, merely "to correct misinterpretations, inaccuracies, or omissions". The broad sweep of the statutory provisions themselves and the clear and persistent statements appearing in the committee reports afford no support for the limitation imposed upon those provisions by the *Reynolds Tobacco* decision, where the foregoing legislative history was neither fully presented to the Court nor apparently considered by it. Moreover, the 1934, or last amendment to these provisions was not even applicable in that case, because the amendatory regulations were issued (May 2, 1934) prior to the enactment of the Revenue Act of 1934, which became law on May 10, 1934. Finally much of the theory underlying the *Reynolds Tobacco* case has since been rejected by the Court. See *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90; *Helvering* v. *Reynolds*, 313 U. S. 428.

Accordingly, we submit that under Section 3791 (b) of the Code, the Treasury had statutory authority to promulgate an amendment to the regulations that would be applicable here. It should not be assumed that the Treasury will abuse that discretion. Indeed, a recent instance of the Treasury's sense of fairness in applying these provisions may be seen in its action following this Court's decision in *Helvering* v. *Hallock*, 309 U. S. 106. The *Hallock* decision had overruled *Helvering* v. *St. Louis Union Trust Co.*, 296 U. S. 39, and thus invalidated the Treasury

regulations that had previously been adopted to reflect the result in the *St. Louis Union Trust Co.* case. But the Treasury recognized that transfers of property may have been made between the date of the *St. Louis Union Trust Co.* decision (1935) and the *Hallock* decision (1940) in reliance upon those regulations. Accordingly, in promulgating amended regulations to reflect the result of the *Hallock* decision the Treasury has specifically provided that all transfers made during the period between the *St. Louis Union Trust Co.* and *Hallock* decisions are to be governed by the rule of the existing rather than the new regulations. T. D. 5008, 1940-2 Cum. Bull. 286.

In the instant case, the amendment to the regulations was permitted to have retroactive as well as prospective operation, merely to remove any possible obstacle that might otherwise prevent the Court for an unduly long time from adjudicating the validity of the tax upon a pure stock dividend imposed by the statute. (Cf. *Helvering* v. *Gerhardt*, 304 U. S. 405, 422–423.) We are informed by the Treasury that it has no intention of harassing taxpayers with respect to liability for past years, and that if *Eisner* v. *Macomber* is overruled, it intends immediately to recommend to Congress legislation which would relieve taxpayers of any unfair retroactive burden that might result from such overruling, just as it did in the Public Salary Tax Act of 1939 (53 Stat. 574) which protected both state and federal employees from the hardship involved in the retroactive application of the overruling of *Collector* v. *Day*, 11 Wall. 113.

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